American Express Company
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June 25, 2018

Via Electronic Delivery

Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

Re: Proposed Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules
Docket No. R–1603; RIN 7100–AF 02

Ladies and Gentlemen:

American Express Company (together with its subsidiaries, "American Express") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Federal Reserve") in response to the Federal Reserve's notice of proposed rulemaking proposing to revise the applicable regulatory capital, capital plan, and stress test rules for certain bank holding companies (the "Proposed Rule"). [1]

American Express strongly supports the efforts of the Federal Reserve to simplify and tailor the application of regulatory capital rules to reflect a firm's "size, complexity, and systemic footprint." [2] We focus our comments here on the opportunity for the Federal Reserve to achieve greater tailoring through the Proposed Rule.

The Proposed Rule generally would apply to bank holding companies ("BHCs") with $50 billion or more in total consolidated assets – those subject to the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") process. This scope currently captures both BHCs that are subject to the U.S. "standardized" approach capital rules and those currently subject to the U.S. "advanced approaches" capital rules ("AA Banks") – *i.e.*, BHCs with $250

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1 *Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules*, 83 Fed. Reg. 18160 (April 25, 2018).

2 *See* Board of Governors of the Federal Reserve System, Staff Memo, April 5, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180410a1.pdf (the "Staff Memo").

billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure (the "250/10 Thresholds").[3]

Although the Proposed Rule would apply to both standardized approach and AA Banks, the "stress capital buffer" ("SCB") requirement would only be added to capital ratios as calculated under the standardized approach.[4] As the Federal Reserve thoughtfully recognizes in the Proposed Rule, incorporating the advanced approaches into stress testing would require "significant resources," would introduce "complexity and opaqueness," and ultimately "could be duplicative," since "both the supervisory stress test and the advanced approaches are calibrated to reflect tail-risks."[5]

In highlighting the significant burden and limited utility of the advanced approaches for stress testing purposes, the Proposed Rule more generally highlights the high cost and limited supervisory benefit of the advanced approaches for all but perhaps the very largest and most complex financial institutions.

American Express believes that the Federal Reserve should use this opportunity to further tailor its capital rules by eliminating the use of the 250/10 Thresholds for determining application of the advanced approaches.[6] We also believe that the Federal Reserve should make similar changes in other rulemakings that use the 250/10 Thresholds, such as the Liquidity Coverage Ratio.

These static asset thresholds are the wrong tool for their supervisory purpose because they do not appropriately reflect the complexity, business models, international activity or actual risk profiles of banking organizations. As Vice Chairman for Supervision Quarles noted recently: "the metrics used to identify internationally active firms – $250 billion in total assets or $10 billion in on-balance-sheet foreign exposures – were formulated well over a decade ago, were the result of a defensible but not ineluctable analysis, and have not been refined since then. We should explore ways to bring these criteria into better alignment with our objectives."[7]

American Express believes that the use of the systemic indicator approach used to identify global systemically important banks ("G-SIBs") to determine application of the advanced approaches would ensure that the scope of coverage of the advanced approaches capital rules is and remains properly calibrated to achieve the Federal Reserve's express purpose of tailoring capital rules based on firms' size, complexity, and systemic footprint.

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[3] 12 C.F.R. § 217.100(b)(1).

[4] The SCB would be calculated based upon the projected decrease in capital a firm experiences under the CCAR "severely adverse" scenario.

[5] *See* Staff Memo at 10; Proposed Rule at 18164.

[6] American Express also believes that the Federal Reserve (and other federal banking agencies) should eliminate use of the 250/10 Thresholds elsewhere as a proxy for complexity in segmenting the industry generally for supervisory purposes.

[7] Randal K. Quarles, Vice Chairman for Supervision, *Early Observations on Improving the Effectiveness of Post-Crisis Regulation*, to the ABA Banking Law Committee Annual Meeting, Jan. 19, 2018, *available at* https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm ("VC Quarles ABA Speech").

I. The Use of Static, Outdated, and Non-Risk-Sensitive Thresholds Results in an Inappropriate Segmentation of the Industry

We strongly agree with the Federal Reserve that it is appropriate to tailor capital rules or other supervisory expectations based upon the complexity, risk profile, and systemic importance of banking organizations. Similarly, we strongly agree with the sentiment of Vice Chairman for Supervision Quarles that "there are additional tailoring opportunities with respect to large firms that are not G-SIBs to ensure that applicable regulation matches their risk."[8] To achieve the proper tailoring, however, it is critical that the criteria used to identify those firms be sufficiently sophisticated, dynamic, and risk-sensitive to avoid being or becoming overly inclusive.

The 250/10 Thresholds are static, arbitrary measures that are unique to the United States and were developed in 2003 – prior to the 2008-09 Financial Crisis – to identify those "internationally active" banking organizations to which the U.S. advanced approaches capital rules would apply. At the time the thresholds were first established, the Federal Reserve made clear that the implementation in the United States of standards for "internationally active" banking organizations was intended to reach only the "largest, most complex banks," *i.e.*, those that were the "most complex banking institutions" and were truly "internationally active."[9]

These thresholds may have been an appropriate proxy at the time for identifying a group seemingly equivalent to today's G-SIBs, but like all fixed asset size thresholds, they were destined to become improper measures over time. Today, two distinct groups – the largest and most complex banking organizations, as well as regional and other traditional banking organizations – are both captured under this same 250/10 Threshold. However, these groups are dramatically different, especially in terms of business model and risk profile. For example:

- Relative to larger and more complex organizations (such as the U.S. G-SIBs), regional and other traditional banking organizations have relatively simple organizational structures, primarily focusing on traditional retail and commercial banking products and services, and have only limited trading and capital markets operations. Broker-dealers and other nonbank operations outside of service-providing affiliates comprise only a small portion of their overall operations.

- Regional and other traditional banking organizations' exposure to capital markets and derivatives activities pale in comparison to that of U.S. G-SIBs.

As a result of the 250/10 Thresholds not taking into account these differences, regulatory requirements that use these thresholds are not appropriately calibrated to the risk profile of individual institutions, and unnecessary regulatory obligations and supervisory expectations

8 Randal K. Quarles, Vice Chairman for Supervision, *Semiannual Supervision and Regulation Testimony*, Before the Committee on Financial Services, U.S. House of Representatives, April 17, 2018, *available at* https://www.federalreserve.gov/newsevents/testimony/quarles20180417a.htm.

9 *Testimony of Vice Chairman Roger W. Ferguson, Jr.*, *Basel II*, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 18, 2003, *available at* http://www.federalreserve.gov/boarddocs/testimony/2003/20030618/default.htm; *see also* Federal Reserve, *Capital Standards for Banks: The Evolving Basel Accord*, 89 Fed. Res. Bull. 395 (Sept. 2003).

intended for the largest and most complex institutions are being imposed on regional and other traditional banking organizations.

Notwithstanding that they have become overbroad and outdated, the 250/10 Thresholds not only continue to be used for purposes of the advanced approaches, they have found increasing use by the Federal Reserve and other U.S. banking agencies in other contexts – whether by using the thresholds themselves, or through reference to the current scope of advanced approaches banking organizations.

Continuing to use (and expanding use of) the pre-crisis 250/10 Thresholds, when more sophisticated, comprehensive, and internationally recognized tools are available, is inappropriate. Post-crisis, the Basel Committee on Banking Supervision (the "Basel Committee") and the Federal Reserve have developed a far-more comprehensive measure for size, complexity, and overall systemic risk of individual banks – the G-SIB systemic indicator approach.[10]

We believe the Federal Reserve (and other U.S. banking agencies) should eliminate their reliance on the 250/10 Thresholds for applying the advanced approaches rules in favor of a more appropriate and tailored metric: the G-SIB systemic indicator approach, which would ensure a more sophisticated and dynamic calibration of regulatory requirements based on banking organizations' business models, complexity, and risk profile.

II. Revisiting the 250/10 Thresholds is Consistent with Recent Legislative and Regulatory Developments

Notably, reconsidering the continued relevance of the 250/10 Thresholds, and their application to regional and other traditional banking organizations, would be consistent with several recent legislative and regulatory developments. As Vice Chairman for Supervision Quarles noted in January, "now is an eminently natural and expected time to step back and assess [the body of post-crisis regulation] . . . to ensure that they are working as intended and . . . it is inevitable that we will be able to improve them, especially with the benefit of experience and hindsight."[11]

S. 2155

Enacted on May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act ("S. 2155"), among other things, amends Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act to raise the systemically important financial institution designation for application of "enhanced prudential standards" ("EPS") from $50 billion in total consolidated assets to $250 billion. Upon enactment of these changes, BHCs with less than $100 billion in total consolidated assets are immediately excluded from application of the EPS, and BHCs with total consolidated assets between $100 billion and $250 billion will be excluded from EPS effective November 24, 2019, absent express action by the Federal Reserve.

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10 *See* Basel Committee, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013); *Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Final Rule*, 80 Fed. Reg. 49,802 (Aug. 14, 2015); 12 C.F.R. § 217.400 *et seq.*

11 *See* VC Quarles ABA Speech.

Enactment of S. 2155 is an important milestone towards achieving a broader right-sizing of post-crisis regulation. It would be similarly timely, appropriate, and consistent with the efforts of the Federal Reserve and Congress[12] to reevaluate the use of the 250/10 Thresholds, which have become outdated and inappropriate for their purpose.

Federal Reserve – CCAR Qualitative Relief

Moreover, the Federal Reserve has already taken action to eliminate at least one static asset threshold in its regulations.[13] In support of that action, the Federal Reserve recognized that foreign exposure may arise from business activities that are not complex, and as a result a metric aimed at accounting for complexity that is based solely on the size of a firm's foreign exposures may be over-inclusive.[14]

U.S. Department of the Treasury

The current Administration has also expressed its desire to leave behind static asset thresholds as triggers for systemic designations or application of enhanced prudential standards. Specifically, in its June 2017 Report on Regulatory Reform, the Treasury Department commented on the need to revisit "arbitrary" asset thresholds:

> Most critically, regulatory burdens must be appropriately tailored based on the size and complexity of a financial organization's business model and take into account risk and impact. In particular, the use of arbitrary asset thresholds to apply regulation has resulted in a "one-size-fits all" approach that has prevented regulators from focusing on a banking organization's most serious risks.
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> Insufficient tailoring results in bank regulators misallocating staff time and resources by focusing on firms that do not present the greatest risks to the financial system. Further, the magnitude of regulatory requirements applicable to regional, mid-sized, and community banks that do not present risks to the financial system requires such banks to expend resources on building and maintaining a costly compliance infrastructure, when such resources would be better spent on lending and serving customers.[15]

The Treasury Department's Office of Financial Research ("OFR") has also publicly supported revisiting the static asset threshold approach. For example, in its recent 2017 Annual Report to Congress, OFR stated: "A multifactor approach that captures risk is superior to using asset size alone to determine the systemic footprint of U.S. banks. . . . For U.S. banks with

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12 *See, e.g.*, Statement of Senator Toomey: "[The EPS threshold] shouldn't be automatically based on the size of the institution; it should be driven by the conduct of the institution, the kind of business they do. . . . I intend to work with regulators to basically have this SIFI designation reflect the activity of the institution rather than just the size." Congressional Record at S1720, March 14, 2018.

13 *Amendments to the Capital Plan and Stress Test Rules; Regulations Y and YY*, 82 Fed. Reg. 9308, 9312 (Feb. 3, 2017).

14 *Id.*

15 U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions*, June 2017, *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

traditional business models, an asset-size threshold for determining whether to apply heightened regulatory standards could create misaligned regulatory compliance costs."[16]

U.S. House of Representatives

Finally, revisiting the use of the 250/10 Thresholds would also be consistent with Congressional direction in the House Committee on Appropriation's report accompanying the 2016 Financial Services and General Government Appropriations Bill, which was incorporated into the 2016 Consolidated Appropriations Act enacted in December 2015, which provides:

> *Basel Standards.*—The Committee is concerned that the U.S. prudential regulators have inappropriately applied several standards developed by the Basel Committee on Bank[ing] Supervision (Basel), which are explicitly designed for only the most internationally active, globally systemic, and highly complex banking organizations to less complex organizations, like regional banking organizations, which have only limited foreign exposure and do not pose a threat to the U.S. or global financial system. The Committee encourages Treasury and other prudential regulators to reexamine the impact of certain liquidity and capital standards as they apply to U.S. regional banks and other less complex organizations. [17]

Fundamentally, static balance-sheet-based thresholds are a poor proxy for risk or complexity and are ripe for reconsideration. We believe the 250/10 Thresholds should be replaced with the G-SIB systemic indicator approach. Using the G-SIB systemic indicator approach would help ensure that the scope of the rules – and any derivative uses of that scope for other regulatory initiatives – remains properly calibrated to capture only the largest and most complex global banking organizations.

III. The Systemic Indicator Approach is a Better Method to Calibrate Regulatory Requirements

As noted above, the Federal Reserve participated in the international development of the systemic indicator approach, and has implemented the approach in the United States for identifying G-SIBs.[18] The systemic indicator approach has two notable advantages over static, asset-based thresholds. First, it evaluates systemic importance across a comprehensive set of attributes – not only asset size, but also interconnectedness, substitutability, complexity, and cross-jurisdictional activity. Second, the data used to evaluate systemic importance are updated periodically to reflect changes over time.[19]

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16 OFR 2017 Annual Report to Congress, *Key Findings from Research and Analysis: Assessing the Systemic Importance of Banks*, Dec. 5, 2017, available at https://www.financialresearch.gov/annual-reports/2017-annual-report/.

17 H.R. Rep. No. 114-194 (2015), at 10.

18 *See* note 10, *supra*.

19 The Federal Reserve's FR Y-15 Banking Organization Systemic Risk Report, which collects data comprising the five components underlying the systemic indicator approach, is submitted by BHCs with total consolidated

The systemic indicator approach provides much more powerful insights than the rudimentary 250/10 Thresholds into complexity, international activities and the actual risk profile of a banking organization – and to the vast differences between regional and other traditional banking organizations and the U.S. G- SIBs. For example, based upon publicly available information:

- The U.S. G-SIBs account for 76% of total exposures for all U.S. BHCs required to submit the Federal Reserve's FR Y-15 Banking Organization Systemic Risk Report ("FR Y-15 Filers"), and whereas the smallest non-custody G-SIB has total exposures of $1.28 trillion, the largest traditional banking organization has only $539 billion.

- U.S. G-SIBs account for 98% of the notional value of all over-the-counter ("OTC") derivatives for all FR Y-15 Filers, and the smallest non-custody G-SIB has OTC derivatives with a notional value of $5.6 trillion, compared to the largest traditional banking organization, which has only $278 billion. Similarly, U.S. G-SIBs accounted for 87% of trading and available-for-sale securities (less high quality liquid assets) for all FR Y-15 Filers; the smallest non-custody G-SIB has $135 billion of such securities, compared to only $16 billion for the largest traditional banking organization.

- U.S. G-SIBs account for 94% of all cross- jurisdictional claims and 95% of all cross-jurisdictional liabilities for FR Y-15 Filers, representing the vast majority of all international claims and liabilities for FR Y-15 Filers. No traditional banking organization has cross-jurisdictional claims or liabilities exceeding 1% of the aggregate amounts for FR Y-15 filers, consistent with the domestic focus and limited international activity of traditional banking organizations. [20]

Perhaps more telling are the ultimate scores of systemic importance when calculated using the systemic indicator data. For example:

- Under the Federal Reserve's systemic indicator methodology a U.S. BHC is deemed to be a G-SIB if its systemic indicator score is 130 or more. Based upon public information, the G-SIB cutoff (130) is more than three times greater than the systemic indicator score of the largest non-custody U.S. banking organization that is not identified as a G-SIB (39); [21] and

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assets of $50 billion or more on a quarterly basis. The aggregate systemic indicators used as the denominators to calculate a banking organization's systemic indicator score are updated on an annual basis.

[20] All FR Y-15 data in this letter are as of December 31, 2014. The remaining systemic indicators similarly demonstrate the vast gulf between U.S. G-SIBs and regional and traditional banking organizations.

[21] Systemic indicator scores were calculated based on FR Y-15 reports as of December 31, 2014, and the Basel Committee's 2014 systemic indicator denominators (converted into U.S. Dollars based on the spot USD/EUR exchange rate prevailing on December 30, 2014). A report compiled by the OFR draws similar conclusions using the Basel Committee's essentially identical methodology. *See* Allahrakha et al., OFR Brief, *Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data* (Feb. 12, 2015), available at http://financialresearch.gov/briefs/files/2015-02-12-systemicimportance-indicators-for- us-bank-holding-companies.pdf. *See also*, OFR 2017 Annual Report to Congress, at fn. 12, above.

- The average systemic indicator score of the eight U.S. G-SIBs (280) is over seven times greater than that of the largest non-custody U.S. banking organization that is not a G-SIB (39).[22]

The systemic indicators and score data make it clear that the U.S. G-SIBs are significantly more complex and internationally active than regional and other traditional banking organizations.[23] In light of the stark differences between U.S. G-SIBs and regional and other traditional banking organizations and the policy goals of tailoring regulatory capital requirements based upon the size, complexity, and risk profile of banking organizations, we believe that the Federal Reserve should eliminate use of the 250/10 Thresholds in the advanced approaches and that the systemic indicator approach should be applied instead.

IV. Conclusion

We respectfully submit that, for the reasons described above, the Federal Reserve should forego its continued use of the static, outdated 250/10 Thresholds in favor of relying upon the more tailored systemic indicator approach in identifying firms to be subject to the advanced approaches capital rules. We believe that these changes would produce a segmentation of the U.S. financial services industry that more appropriately captures the risk associated with covered organizations, asset classes, and liabilities, and thus would result in a supervisory focus that is better aligned to the objectives of the Federal Reserve.

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22 *Id.*

23 We believe it is critical for the Federal Reserve and other U.S. banking agencies to keep these very real differences between U.S. G-SIBs and regional and other traditional banking organizations in mind, particularly given the increasing use of the 250/10 Thresholds outside the context of the Basel Committee's standards.

Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Federal Reserve and would be happy to discuss any of them further at your convenience. If we may be of further assistance, please contact me at 212-640-2396 or david.l.yowan@aexp.com.

Sincerely,

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